

A PRACTITIONER'S PERSPECTIVE ON EMERGING LEGAL TRENDS

Massachusetts Appeals Court Clarifies How Irrevocable Trusts Can Disqualify MassHealth Eligibility

On April 15, 2016, the Massachusetts Appeals Court issued a decision, entitled *Heyn v. Dir. of Office of Medicaid*, 48 N.E. 3d 480 (Mass. App. Ct. 2016), in which the Court offered important clarification concerning the protection afforded to a client's assets when a self-settled irrevocable *inter vivos* trust is established.¹ The opinion focused, in part, upon protecting the trust principal from constituting "countable assets" in determining eligibility for Massachusetts' Medicaid program, known as MassHealth. The threshold for MassHealth eligibility requires an applicant to have less than \$2,000 in assets. The seminal question for irrevocable trusts is whether the trust principal is counted as an asset against the \$2,000 threshold for MassHealth eligibility.

The Heyn court held that, contrary to the determination of the MassHealth hearing officer, there were no circumstances under which the trustee could distribute trust principal to the grantor. In other words, the Heyn decision establishes a backstop to what may, in theory, satisfy the "any circumstances" criteria in determining "countable assets" regarding the eligibility for MassHealth.

Massachusetts Regulations and Irrevocable Trusts

The Massachusetts Code of Regulations applies the trust and transfer rules of 42 U.S.C. 1396p to the examination of irrevocable trusts for purposes of determining MassHealth eligibility. 130 CMR 520.023 ("The trust and transfer rules at 42 U.S.C. 1396p apply to trusts or similar legal devices created on or after August 11, 1993, that are created or funded other than by a will.") The *Heyn* decision affirmed the application of 42 U.S.C. § 1396p(d)(3)(B) to the treatment of irrevocable trusts when determining eligibility for MassHealth benefits. Section 1396p(d)(3)(B) states, in full:

(B) In the case of an irrevocable trust—

- (i) if there are any circumstances under which payment from the trust could be made to or for the benefit of the individual, the portion of the corpus from which, or the income on the corpus from which, payment to the individual could be made shall be considered resources available to the individual, and payments from that portion of the corpus or income—
 - (I) to or for the benefit of the individual, shall be considered income of the individual, and
 - (II) for any other purpose, shall be considered a transfer of assets by the individual subject to subsection (c) of this section; and
- (ii) any portion of the trust from which, or any income on the corpus from which, no payment could under any circumstances be made to the individual shall be considered, as of the date of establishment of the trust (or, if later, the date on which payment to the individual was foreclosed) to be assets disposed by the individual for purposes of subsection (c) of this section, and the value of the trust shall be determined for purposes of such subsection by including the amount of any payments made from such portion of the trust after such date.

¹ This article is based upon the Massachusetts legal and regulatory environment. Therefore, it would be necessary to become conversant with the applicable law and regulatory approach in individual jurisdictions to determine the extent to which the material presented is applicable and relevant to your practice.

42 U.S.C. § 1396p(d)(3)(B). Thus, whether the trust principal in an irrevocable trust constitutes a “countable asset” in determining eligibility for MassHealth is contingent upon whether any portion of the trust principal might under “any circumstances” be paid to or for the benefit of the grantor. Although the *Heyn* holding did not reverse the holding of the Massachusetts Appeals Court in *Doherty v. Dir. of Office of Medicaid*, 74 Mass. App. Ct. 439 (2009) (discussed below), the *Heyn* decision provides important clarification to an unsettled area of the law that has led to inconsistent decisions from hearing officers at fair hearings before the MassHealth Board of Hearings, as well as uncertainty among the trusts and estates bar concerning the level of protection afforded by irrevocable trusts.

Doherty and Irrevocable Trusts

In 2009, the *Doherty* court recognized the “Legislature’s explicit direction that Medicaid benefits be made available only ‘to people who do not have sufficient income or resources to provide for themselves’” and the conflicting “desire of ‘persons with some means, perhaps even considerable means, to preserve their assets in the face of the large medical expenses faced. . . by elderly persons.’” 74 Mass. App. Ct. at 439 (citations omitted). In its decision, the *Doherty* court emphasized that self-settled, irrevocable trusts may, if appropriately drafted and structured, insulate trust assets such that those assets will be deemed unavailable to the settlor for purposes of determining eligibility for MassHealth benefits. *Id.* at 442-443. Nevertheless, the *Doherty* court cited 42 U.S.C. § 1396p(d)(3)(B) as controlling law requiring that the assets of an irrevocable trust are available to MassHealth if, under any circumstances, payment from the trust could be made to or for the benefit of the grantor. *Id.* at 440 n4, quoting 42 U.S.C. § 1396p(d)(3)(B) (1993) (“In the case of an irrevocable trust—(i) if there are any circumstances under which payment from the trust could be made to or for the benefit of the individual, the portion of the corpus from which. . . payment to the individual could be made shall be considered resources available to the individual.”)

The *Doherty* court proceeded to examine an irrevocable trust that expressly stated, the trustee may “make no distributions of principal from the Trust, to or on behalf of” the grantor. 74 Mass. App. Ct. at 441. Notwithstanding this provision, the *Doherty* court examined other provisions in the Trust document that provided the grantor with certain retained power over the trust principal, including the right to “appoint any part or all of the principal of the Trust fund to any one or more of” the grantor’s descendants or siblings. *Id.* The grantor also retained a life estate in her home, which was originally part of the trust principal, resulting in an effective veto power over any sale of the property. *Id.* Finally, the Trust conveyed authority to the trustee to “pay over and distribute the entire principal of” the Trust to the beneficiaries, including the grantor, so long as the trustee determined that it was inadvisable or unnecessary to continue the Trust. *Id.* Although the grantor argued that the controversial Trust language that made it theoretically possible to convey trust assets back to the grantor was nothing more than “economically meaningless administrative boilerplate,” the *Doherty* court decided that the “any circumstances” test rendered such discretionary authority vested in the trustee sufficient to deem the trust principal a “countable asset” for the purpose of determining the grantor’s MassHealth eligibility. *Id.* at 441-43.

Lessons Learned/MassHealth and Irrevocable Trusts

Following the *Doherty* decision, MassHealth began scrutinizing irrevocable trusts to determine whether payment from the trust could be made to the grantor *under any circumstances* and, if such payment to the grantor was theoretically possible, the principal of the irrevocable trust was deemed a “countable asset” for purposes of determining MassHealth eligibility. Irrespective of whether trust language was conflicting, so long as “any circumstances” were triggered by any provision of the irrevocable trust. Denials of MassHealth applications increased significantly and hearing officers at fair hearings before the MassHealth Board of Hearings relied upon the *Doherty* decision as precedent to treat the principal of irrevocable trusts as “countable assets” against the \$2,000 threshold for MassHealth eligibility. Since 2009, the trust and estates bar has awaited further clarification from the Massachusetts Appeals Court (or the SJC) regarding irrevocable trust language that would be deemed sufficient to protect the trust principal from constituting “countable assets” in determining eligibility for MassHealth.

In *Heyn*, the Court of Appeals reviewed a MassHealth hearing officer's determination that the trustee's authority to distribute all or part of the irrevocable trust principal to the trust's beneficiaries, as well as the grantor's right to appoint all or part of the trust principal to her issue, meant that, in theory, the trust principal could be distributed, in its entirety, to someone, such as the grantor's children, who would simply return the equivalent amount to the grantor. 48 N.E. 3d at 484. The MassHealth hearing officer also determined that the Trust included a provision that allowed the grantor to transfer any trust asset, including the home in which she resided, in exchange for assets of equivalent value. Based upon this decision, the grantor theoretically could sell her house and purchase an annuity that would result in annual annuity payments that the hearing officer concluded were "countable assets" for purposes of determining eligibility for MassHealth. *Id.* at 485.

The *Heyn* court disagreed on both counts, concluding that the ability of a grantor's children to provide her with a gift is no different than if the children were independently wealthy and decided to provide the grantor with a gift. *Id.* at 486. When such a theoretical gift is received by the grantor, it would constitute "countable assets" for purposes of determining eligibility for MassHealth, but, importantly, unless and until such a gift is given, the grantor's MassHealth eligibility remains unaffected. *Id.* With respect to the theoretical annuity payments (if the grantor sold her home and purchased an annuity of equal value with the proceeds), the *Heyn* court concluded that MassHealth's conclusion "misapprehends the nature of annuity payments." *Id.* at 485. Instead, from each annuity payment, "only the investment income portion would be available for distribution to the grantor from the trust; that portion of each payment representing a return of capital would be required by the trust instrument to be retained in the trust." *Id.* Thus, even if assets of the trust were invested in an annuity, the trust principal is preserved in the form of return of capital that is invested in the annuity and, therefore, annuity payments to the grantor are not "countable assets" for purposes of determining eligibility for MassHealth. *Id.*

The *Heyn* court held that, contrary to the determination of the MassHealth hearing officer, there were no circumstances under which the trustee could distribute trust principal to the grantor. 48 N.E. 3d at 486. In other words, the *Heyn* decision establishes a backstop to what may, in theory, satisfy the "any circumstances" criteria of 42 U.S.C. § 1396p(d)(3)(B) in determining "countable assets" regarding the eligibility for MassHealth. The MassHealth decision in *Heyn* offered grounds upon which trust principal may be distributed back to the grantor, however, the *Heyn* court rejected these theoretical grounds as insufficient as a matter of law. Thus, the *Heyn* decision offers clarity to the trusts and estates bar that irrevocable trusts can be drafted in order to protect the

trust principal from constituting "countable assets" in determining eligibility for MassHealth. However, in dicta, the *Heyn* court identified yet another important open question under this area of the law. "The defendant makes no argument that the life estate retained by [the grantor] might itself have a value that could affect her eligibility for benefits, stating in its brief that it is 'a correct statement of the law under *Cohen* [v. Commissioner of the Div. of Med. Assistance, 423 Mass. 399, 668 N.E.2d 769 (1996), cert. denied sub nom. *Kokoska*, by *Kokoska v. Bullen*, 519 U.S. 1057, 117 S.Ct. 687 (1997),] and its progeny' that retention of a life estate does not render an individual ineligible for benefits. We do not consider the question." *Heyn*, 48 N.E. 3d at 482 n3. Thus, while noting the issue of a grantor's life estate in his or her property, the Appeals Court has not expressly decided whether, if challenged, such life estate interest would be deemed a "countable asset" for purposes of determining whether the \$2,000 threshold for MassHealth eligibility has been satisfied.

Risk Management Considerations

In light of the state of irrevocable trust law following the *Heyn* decision, it is recommended that trusts and estates bar review all standard form irrevocable trusts to determine their compliance with the *Heyn* decision prior to use of such irrevocable trust forms for future clients. Based upon the continuing evolution of this area of the law, it is also recommended that engagement letters include boilerplate language stating that the attorney is not obligated to contact the client in the event that the law changes. Whether to contact former clients for whom irrevocable trusts have been previously drafted, to discuss whether a new irrevocable trust document is warranted (and, thereby, reopening the five-year lookback period) is a case-specific decision that is not subject of this *In Practice* article.

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